Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of		
Ameritech Operating Companies **Tariff FCC No. 2** **Transmittal No. 1312**	)	**WC Docket No. 02-319**
Nevada Bell Telephone Companies **Tariff FCC No. 1** **Transmittal No. 20**	)	
Pacific Bell Telephone Company **Tariff FCC No. 1** **Transmittal No. 77**	)	
Southern New England Telephone Companies **Tariff FCC No. 39** **Transmittal No. 772**	)	
Southwestern Bell Telephone Company **Tariff FCC No. 73** **Transmittal No. 2906**	)	

WORLDCOM OPPOSITION

WorldCom, Inc. (WorldCom) hereby submits its opposition to the Direct Case filed in the above-captioned proceeding on October 31, 2002 by SBC Communications, Inc. (SBC).

I. The Proposed Tariff Language Violates Sections 201 and 202 of the Act

All suppliers of telecommunications services seek to reduce credit risk to the greatest extent possible. However, the degree to which a competitive carrier can reduce its

credit risk is limited by market forces. As the carrier takes increasingly stricter measures to control its risk of nonpayment, by demanding larger security deposits or demanding such deposits from a larger population of customers, at some point the carrier's customers respond to those growing burdens by switching to competing carriers that are willing to accept higher levels of risk in order to win business. In that manner, the market balances competitive carriers' credit risk against the burdens placed on customers.

By definition, however, market forces cannot constrain the ability of a dominant carrier such as SBC to impose excessive burdens on customers as it seeks to reduce its credit risk. Because dominant carriers have no concerns that an overly stringent security deposit policy could drive away customers, a dominant carrier is unlikely, in the absence of regulatory constraints, to balance the carrier's interest in reducing credit risk against the burdens placed on the carrier's customers.

On numerous occasions, the Commission has found that dominant LEC tariff terms and conditions are just and reasonable only if they reflect a similar balancing of carrier and customer interests to that found in a competitive market. For example, in considering security deposit provisions, the Commission has "recogniz[ed] that it is prudent for the telephone company to seek to avoid non-recoverable costs imposed by bad credit risks."[1] At the same time, however, the Commission has rejected "vague charges [that] could become unreasonably burdensome," provisions that "allow[ed] the telco unnecessarily broad discretion" and provisions that had "potential anticompetitive effects."[2]

[1] Investigation of Access and Divestiture-Related Tariffs, Memorandum Opinion and Order, CC Docket No. 83-1145 Phase I, 97 FCC 2d 1082 (1984) (Phase I Order), Appendix D, discussion of Section 2.4.1(A).
[2] Id.

Similarly, when considering 1987 BellSouth tariff revisions that were intended to mitigate the impact of potential customer bankruptcy, the Commission "recognize[d] that the proposed tariff revisions could reduce BellSouth's liability under the circumstances that it has described."[3] At the same time, however, the Commission "believe[d] . . . that the revisions may place undue burdens on customers . . . . Provisions that more directly applied only to those customers that might default and that are supported with adequate documentation would be more reasonable."[4]

As the Commission recognizes in the Designation Order, the above-captioned tariff transmittals would "significantly alter the balance between SBC and its interstate access customers with respect to the risks of nonpayment of interstate access bills that was struck in the early 1980s when access charges were instituted."[5] The Commission should reject the SBC transmittals because the tariff language proposed by SBC does not balance SBC's interests against those of its customers. The proposed tariff would provide SBC with a far better level of protection against bad debt than could be obtained in a competitive market and would impose excessive burdens on SBC's customers.

A. SBC Has Failed to Provide Information Required by the Designation Order

As an initial matter, SBC's Direct Case fails to meet its burden of proof under section 204 because it does not comply with the Designation Order's requirement that SBC

[3] Annual 1987 Access Tariff Filings, Memorandum Opinion and Order, 2 FCC Rcd 280, 304-305 (1986).
[4] Id.
[5] Designation Order at ¶ 14.

demonstrate how each of the factors listed in the proposed tariff language "is a valid predictor of whether the customer will pay its interstate access bill."[6]

In its Direct Case, SBC responds to the Designation Order's question about he predictive power of its proposed tariff by asserting that bond ratings and payment history are correlated with risk (SBC does not even attempt to show that the Dun & Bradstreet or Paydex ratings are valid indicators of risk).[7] SBC fails to recognize, however, that it is not enough to show that bond ratings or D&B scores or payment history are correlated with risk. Even assuming arguendo that bond ratings or D&B scores or payment history are reasonable factors to examine, the impact of SBC's scheme would be determined in large part by the particular "triggers" specified in SBC's transmittals, i.e., the "investment grade" trigger for the bond rating criterion, the "two months late in the preceding twelve months" trigger for the late payment criterion, or the "fair" and "high risk" triggers for the D&B scores. It is those triggers that determine which customers would be targeted for security deposit requests, and thus determine the level of credit risk that SBC would bear. Consequently, in order to be able to assess the validity of SBC's scheme, the Commission would have to be able to evaluate the credit risk and customer burdens associated with the particular triggers proposed by SBC, not merely the general utility of bond ratings or D&B scores or payment history as measures of risk. SBC has, however, failed to provide the Commission with any information about the credit risk or customer burdens that would result from application of the particular triggers proposed in its transmittals.

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[6] Designation Order at ¶ 20.

[7] Direct Case at 21 "Studies by Moody's and S&P indicate that the risk of default increases from 4 companies per 1,000 to 100 companies per 1,000 as rated companies fall from investment grade to the lowest speculative grade.")

Unless SBC simply picked the triggers out of thin air – which is, of course, entirely possible -- SBC must have estimated the level of uncollectibles that its proposed scheme would yield and the risk characteristics of the customers that its proposed policy would capture. Because SBC has failed to provide that information to the Commission in response to the Designation Order's question about the predictive power of its proposed scheme, the Commission must find that SBC has failed to meet its burden of proof under section 204(a). Without specific information about SBC's credit risk and the corresponding customer burdens, the Commission cannot readily determine whether SBC is proposing a balanced approach that targets only those customers that present a significant risk of nonpayment, or is instead proposing an unreasonably stringent approach that targets any customer that presents even the slightest risk of nonpayment.

B. SBC Already Enjoys Good Protection Against Credit Risk

SBC justifies its efforts to reduce its credit risk by pointing to an increase in SBC's uncollectibles in 2000 and 2001. But an increase in uncollectibles is, by itself, largely irrelevant to the question of whether SBC's existing tariff language already strikes a reasonable balance between SBC and its customers.

As an initial matter, because uncollectibles always vary with the business cycle, an increase in SBC's uncollectibles from one year to the next is not necessarily an indicator of a permanent increase in SBC's level of risk. Most of the factors that SBC cites as driving the increase in uncollectibles are one-time events, linked to the end of the telecommunications investment boom of the late 1990s.

Moreover, even if the increase in SBC's uncollectibles reflects a permanent increase in SBC's risk, that would still not support SBC's claim that its existing tariff does not adequately balance the interests of SBC and its customers. SBC's risk profile of 1984 or 1990 is not the standard by which the reasonableness of SBC's transmittals should be judged. If, as SBC claims, SBC's business has become riskier because of regulatory and legislative determinations to permit "the entry of numerous carriers into the telecommunications sector,"[8] then it would be inconsistent with those decisions to restore SBC's risk profile to that of a monopoly carrier in the more heavily regulated market of 1984 and 1990. In return for granting the ILECs increasing flexibility to respond to new competition, the Commission has at the same time taken steps to eliminate regulations that insulate the ILECs from risk.[9] SBC's effort to restore its uncollectibles percentage to the level it enjoyed in 1984 or 1990 is inconsistent with those steps.

Notably, there is no evidence that the increase in SBC's uncollectibles in 2000 and 2001 has left SBC facing greater risk than the firms against which SBC competes.

- The increase in uncollectibles in 2000 and 2001 is not a phenomenon that has uniquely affected SBC. While SBC's uncollectibles may have increased in 2000 and 2001, every other firm in the telecommunications industry also saw its uncollectibles increase during the same period. Time Warner Telecom, for example, recently reported to the SEC that its uncollectibles expense has increased due to customer bankruptcies.[10]

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[8] Direct Case at 17.
[9] See, e.g., Access Charge Reform, Fifth Report and Order, CC Docket No. 96-262, released August 27, 1999, at ¶ 164 (eliminating low-end adjustment mechanism).
[10] Time Warner Telecom, SEC Form 10-K, March 28, 2002, at 34.

- SBC was not uniquely vulnerable to the bankruptcies of Global Crossing and other customers in 2000 and 2001. Competitive firms, which SBC seems to believe have greater flexibility to protect themselves against bad debt, were in fact as vulnerable as SBC to the impact of customer bankruptcies. For example, Level 3, WorldCom, Z-Tel, AT&T, Sprint, and Primus Telecommunications were among the largest unsecured creditors of Global Crossing.[11] Similarly, Covad, WorldCom, AT&T, Williams, Touch America, and Nextel were among the largest unsecured creditors of XO Communications.[12]
- SBC fails to respond to the Designation Order's request that SBC provide data concerning the level of uncollectibles in the broader marketplace[13] – even though, as a participant in the wireless, long distance, and Internet markets, SBC should at least be able to compare the uncollectibles experienced by its LEC operations with the level of uncollectibles in those other, more competitive, markets.

Given that there is no evidence that SBC faces greater risk than the carriers against which it competes, the Commission must find that SBC's existing security deposit tariff language already strikes a reasonable balance between SBC's interests and that of its customers. Any step to further reduce SBC's credit risk would not reflect a reasonable balancing of carrier and customer interests, and thus would be unlawful under section 201.

Finally, there is no merit to SBC's contention, repeated in its Direct Case, that non-dominant carrier tariffs provide a benchmark against which the reasonableness of SBC's

[11] http://news.findlaw.com/hdocs/docs/globalcrossing/glblx012802ch11pet.pdf
[12] http://www.bankrupt.com/xo.txt
[13] Direct Case at 28.

tariff should be judged.[14] The Commission has consistently rejected ILECs' claims that they should be permitted the same tariffing flexibility as nondominant carriers. It is the Commission's longstanding policy that dominant carrier tariff transmittals are subject to a higher level of scrutiny in the tariff review process.[15] That higher level of scrutiny is necessary because dominant carriers continue to possess market power. Nondominant carriers, by contrast, "simply cannot rationally price their services in ways which, or impose terms and conditions which, would contravene Sections 201(b) and 202(a) of the Act."[16] If a nondominant carrier sought to implement a security deposit policy that did not reasonably balance the interests of the carrier with the interests of its customers, that carrier "would lose its market share as its customers sought out competitors whose prices and terms and more reasonable."[17] By contrast, because SBC remains a dominant carrier, market forces cannot ensure that SBC's security deposit policy is just and reasonable. Consequently, the Commission must ensure, through the tariff review process, that SBC's tariff limits SBC to a security deposit policy that reasonably balances SBC's interests with those of its customers.

C. SBC's Proposed Criteria for Triggering Security Deposit Requests are Unreasonable

Not only has SBC failed to demonstrate any basis for a further reduction in its credit risk, but the particular scheme contained in the SBC transmittals is patently unjust and

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[14] Direct Case at 29; See SBC Opposition to Petition to Reject or, in the Alternative, Suspend and Investigate, August 15, 2002, at 7-8.
[15] See, e.g., Southwestern Bell Telephone Company, Revisions to Tariff FCC No. 73, Transmittal No. 2316, Order, 9 FCC Rcd 1883, 1884 ¶ 8 (1994).
[16] Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorization Therefor, First Report and Order, 86 FCC 2d 1, 31.

unreasonable. It would provide SBC with a far better level of protection against bad debt than SBC could obtain if the access market were competitive.

1. SBC's "Investment Grade" Trigger Would Not be Commercially Viable in a Competitive Market

WorldCom does not use a bond rating-based test, much less a bond rating-based test with an "investment grade" trigger, in determining whether a customer's financial condition might warrant a request for some type of security. And it is highly unlikely that any competitive carrier employs a security deposit policy that either directly or indirectly targets all non-investment grade customers. Although "non-investment grade" customers may be riskier than "investment grade" customers, most "non-investment grade" customers still possess sufficient liquidity to continue paying their bills for the foreseeable future. According to Standard & Poor's, for example, a firm with a "B" rating "currently has the capacity to meet its financial commitment on the obligation."[18] Similarly, according to Moody's, the default rate for a "B1"-rated issuer is only 3.71 percent[19] -- and the credit loss rate, which includes amounts recovered during bankruptcy proceedings, is even lower. If a competitive carrier were to demand security deposits from such customers, it would quickly lose those customers to other carriers willing to absorb such a minimal level of risk without demanding a security deposit.

It should not be surprising that a below-investment grade bond rating is not a commercially viable trigger for security deposit requests. The investment grade rating was not developed to determine the point at which a security deposit would be appropriate in a

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[17] Id.
[18] Standard & Poor's Corporate Ratings Criteria at 8 (http://www2.standardandpoors.com/spf/pdf/fixedincome/corpcrit2002.pdf).
[19] Moody's Investors Service, "Default and Recovery Rates of Corporate Bond Issuers," February 2002, at 14,

commercial transaction; rather, the term "investment grade" was originally used by regulatory bodies to connote obligations eligible for investment by institutions such as banks, insurance companies, and savings and loan associations.[20] There is no basis for the Commission to find that risk level of a pension fund or bank, which operate under government regulations designed to ensure stability, is the appropriate benchmark for SBC's security deposit tariff.

2. SBC's Late Payment Trigger Would Not be Commercially Viable in a Competitive Market

A carrier subject to market forces would not find it to be commercially viable to assess a security deposit on any customer with two late payments in a year. Indeed, a payment history of two late payments in a year is so common as to be useless as a predictor of risk. Any competitive carrier that sought to impose such a policy would quickly lose its customers to carriers that employed a more targeted approach to controlling their credit risk.

It is disingenuous for SBC to contend that the "two months late payment in a year" criterion is simply a "clarification" of existing tariff language that permits SBC to require a security deposit from a customer "which has a proven history of late payments."[21] To the best of WorldCom's knowledge, neither SBC nor any other ILEC has in the past claimed that two late payments in a year, no matter how inconsequential, rise to the level of a "proven history of late payment." Nor could SBC have sustained such an interpretation of its tariff. When the Commission adopted the "proven history of late payment" language in 1984, the Commission made clear that the intent of that language was to avoid "non-

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Exhibit 13. (http://riskcalc.moodysrms.com/us/research/defrate/02defstudy.pdf).
[20] Standard & Poor's Corporate Ratings Criteria at 9 (http://www2.standardandpoors.com/spf/pdf/fixedincome/corpcrit2002.pdf).
[21] Direct Case at 4.

recoverable costs imposed by bad credit risks."[22] SBC has not demonstrated, and could not demonstrate, that two late payments in a year identifies only those customers that are "bad credit risks," i.e., that present a substantial risk that they will not pay their bills.

3. SBC's Proposed Policy Would Reduce Its Risk to Zero

Not only are the specific criteria proposed by SBC far more stringent than any competitive carrier could employ, but those criteria would combine to provide SBC with a level of credit risk that would be far lower than any competitive carrier could obtain. In fact, SBC's uncollectibles under its proposed policy would probably be lower than SBC experienced even in the "best" years in the past.

Although the lack of data in SBC's Direct Case makes it difficult to estimate SBC's uncollectibles rate under its proposed scheme, the available evidence indicates that SBC's uncollectibles percentage would approach zero. Under SBC's scheme, the only large customers that would not be required to pay a security deposit under the bond rating criterion would be investment grade firms that have not been placed on review for a potential downgrade. According to Moody's, the default rate for such firms is only slightly greater than zero – *less than 0.06 percent*.[23] SBC's proposed scheme reduces that miniscule risk still further through application of the late payment criterion and D&B score-based criterion, which would likely capture many investment grade firms that managed to escape the bond rating-based criterion and many customers without rated debt.

While it is understandable that SBC would want to reduce its credit risk as close to zero as possible, such a policy is not just and reasonable. In order to achieve such a low

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[22] Phase 1 Order, Appendix D, Review of Section 2.4.1(A).
[23] Moody's Investors Service, "Default and Recovery Rates of Corporate Bond Issuers," February 2002, at 9. (http://riskcalc.moodysrms.com/us/research/defrate/02defstudy.pdf).

level of risk, the tariff language proposed in the SBC transmittals would demand security deposits from any customer that presents even the slightest risk of nonpayment. No firm operating in a competitive market could ever hope to implement such a broad-based security deposit policy; market forces prevent competitive firms from demanding security deposits from customers other than the very limited number that present a substantial credit risk.

D. The Proposed Tariff Language Conflicts with the Bankruptcy Code

In the SBC transmittals, SBC proposes to amend its tariff to allow SBC to demand a security deposit or advance payment from any customer that has "commenced a voluntary receivership or bankruptcy proceeding (or had a receivership or bankruptcy proceeding initiated against it)."[24] That provision is unlawful because it conflicts with the U.S. Bankruptcy Code.

Under Section 366 of the Bankruptcy Code, utilities such as SBC may not discontinue service unless the debtor fails to furnish "adequate assurance" of payment in the form of a "deposit or other security." SBC contends that its proposed tariff language is consistent with the Bankruptcy Code because, it claims, the amount constituting adequate assurance may be initially set by the utility.[25] However, "[t]he bankruptcy courts are in agreement that section 366(b) vests in the bankruptcy court the exclusive responsibility for determining the appropriate security which a debtor must provide to its utilities to preclude termination of service for non-payment of pre-petition utility bills. . . ."[26] Given that the bankruptcy court has "exclusive responsibility" to determine "the appropriate security,"

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[24] See, e.g., SWBT Transmittal No. 2906, Original page 2-55.3.
[25] Direct Case at 17.
[26] See, e.g., Adelphia Business Solutions et al., 2002 Bankr. LEXIS 705, *48 (citing Begley v. Philadelphia

SBC's proposal to fix that security by tariff plainly creates a conflict with the Bankruptcy Code.

II. SBC Has Failed to Satisfy the Substantial Cause Test

A. The SBC Transmittals Are Subject to the Substantial Cause Test

SBC is simply wrong when it contends that the substantial cause test is inapplicable because "SBC's tariff revisions affect only the general tariff sections and . . . do not modify the terms or conditions of any SBC term plan."[27] The substantial cause test is applicable to the SBC transmittals because term plan customers are subject to the existing security deposit provisions of SBC's tariff, and would become subject to the new tariff language if the SBC transmittals were to take effect. Contrary to SBC's claim, it is irrelevant that the security deposit language is not explicitly repeated in each of the term plan sections of SBC's tariffs.

SBC is also wrong when it contends that the substantial cause test is inapplicable because SBC did not "expressly" restrict its ability to make changes to the security deposit provisions applicable to term plans.[28] The Commission has never said that the substantial cause for change test applies only when a dominant carrier's tariff contains an explicit promise not to alter a material term or condition. In fact, the Commission has said that the substantial cause test applies even if the tariff contains a "sweeping reservation to unilaterally change any and all terms and conditions of service."[29]

Elec. Co., 41 B.R. 402 (E.D. Pa. 1984), aff'd 760 F.2d 46 (3rd Cir. 1985)) (emphasis added).
[27] Direct Case at 33.
[28] Direct Case at 34.
[29] RCA American Communications, Inc., Memorandum Opinion and Order, 86 FCC 2d 1197, 1202 (1981)

Permitting SBC to make changes to the security deposit provisions applicable to term plans would be at odds with the policy basis for the substantial cause test. In the RCA Americom Decisions, the Commission stated that it "strikes us as anomalous that a carrier could use the tariff filing process to prevent any of its service terms from being enforced against it by customers, while at the same time bind customers to all the tariff provisions for as long as the carrier wishes . . . ."[30] Given that existing term plan customers are bound to SBC by substantial termination liabilities, it would be unfair and anomalous if SBC could unilaterally change the security deposit regulations or other material provisions of those term plans. Term plan customers have made multi-year commitments to SBC with the expectation that they would have to pay security deposits only if they had a "proven history of late payment."

B. SBC Has Not Met the Requirements of the Substantial Cause Test

SBC contends that it meets the substantial cause test because, it asserts, "the exponential rise in bad debt experienced by SBC renders these tariff provisions a necessity."[31] But such generalized assertions of potential harm do not provide the requisite showing.[32] It is well established that mere reductions from anticipated revenues do not constitute substantial cause.[33] Rather, the carrier must demonstrate unanticipated changes in business circumstances of such degree that they would "constitute an injury to [the carrier]

[30] RCA American Communications, Inc., Memorandum Opinion and Order, 84 FCC 2d 353, 358-359 ¶ 17.
[31] Direct Case at 37.
[32] AT&T Communications Contract Tariff No. 360, Order, 11 FCC Rcd 3194, ¶ 21 (1995) (AT&T Contract No. 360 Order).
[33] AT&T Communications Revisions to Tariff FCC No. 2, Order, 5 FCC Rcd 6777, 6779 ¶ 21 (1990) (AT&T

that outweigh[s] the existing customers' legitimate expectation of stability."[34] The Commission has, for example, suspended tariffs when the customer failed to demonstrate that "its projected losses [were] sufficiently large or certain to demonstrate 'substantial cause.'"[35]

SBC cannot demonstrate injury sufficient to outweigh existing customers' legitimate expectation of stability. ARMIS data show that SBC's uncollectibles rate for special access, which is a good proxy for SBC's term plan uncollectibles,[36] was extremely low in 2001 – about 0.5 percent ($22.3 million of SBC's $4.37 billion in special access revenues).[37]

Moreover, SBC is unable to show that "it will fail to recover its costs or that net revenues [from term plan services] will become negative."[38] Indeed, rate of return data show that the modest rate of uncollectibles on term plan services has caused SBC no injury at all. SBC earned an astonishing 54.6 percent on special access services in 2001,[39] far above SBC's cost of capital and the Commission's most recently-prescribed rate of return of 11.25 percent. Even if there has been a sudden spike in SBC's uncollectibles in 2002, that increase (1) would only be temporary; and (2) would still leave SBC's earnings far above just and reasonable levels.

III. Conclusion

Tariff No. 2 Order).

[34] Id.

[35] AT&T Contract No. 360 Order at ¶ 20.

[36] Special access services account for the vast majority of SBC's term plan revenues.

[37] SBC ARMIS 43-01, col.s, lines 1060, 1090.

[38] AT&T Tariff No. 2 Order, 5 FCC Rcd at 6779, ¶ 21.

[39] SBC ARMIS 43-01, col.s, lines 1910 (total SBC special access average net investment of $3.5 billion), 1915 (total SBC special access return of $1.9 billion).

For the reasons stated herein, the Commission should reject the above-captioned SBC Transmittals.

Respectfully submitted,
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